



Department of Correctional Services

# **PRESENTATION TO THE PORTFOLIO COMMITTEE**

**PREPARATION FOR AND NEGOTIATIONS WITH  
PRIVATE PARTIES TO THE TWO PPP CORRECTIONAL  
CENTRES CONTRACTS TO IMPROVE VALUE FOR  
MONEY**

Bloemfontein Prison

**By  
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CONSORTIUM  
10 August 2006**





## Objective of the Presentation

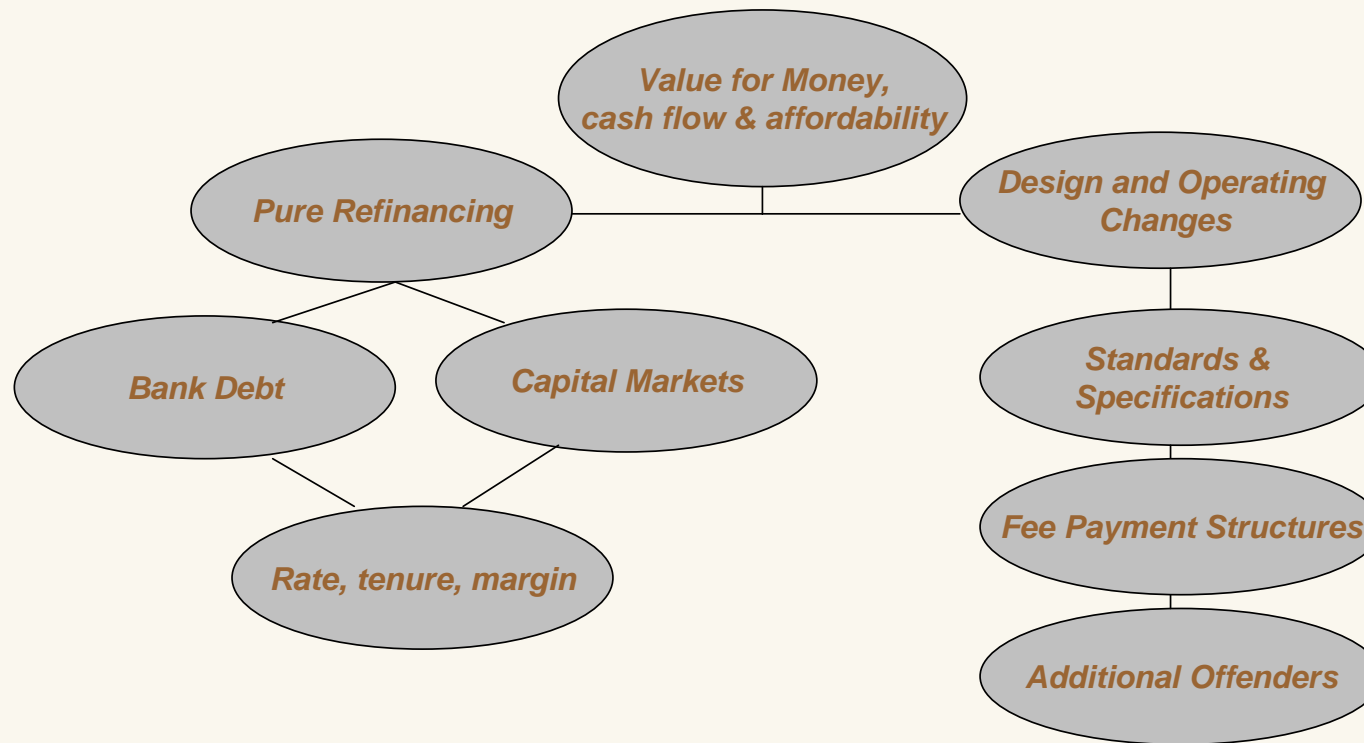
Summary and highlights of report detailing:

- ◆ Pure refinancing issues;
- ◆ Design and operational changes;



# Approach to Assignment

## Elements of assignment:





## Approach to Assignment

DCS Cost components:

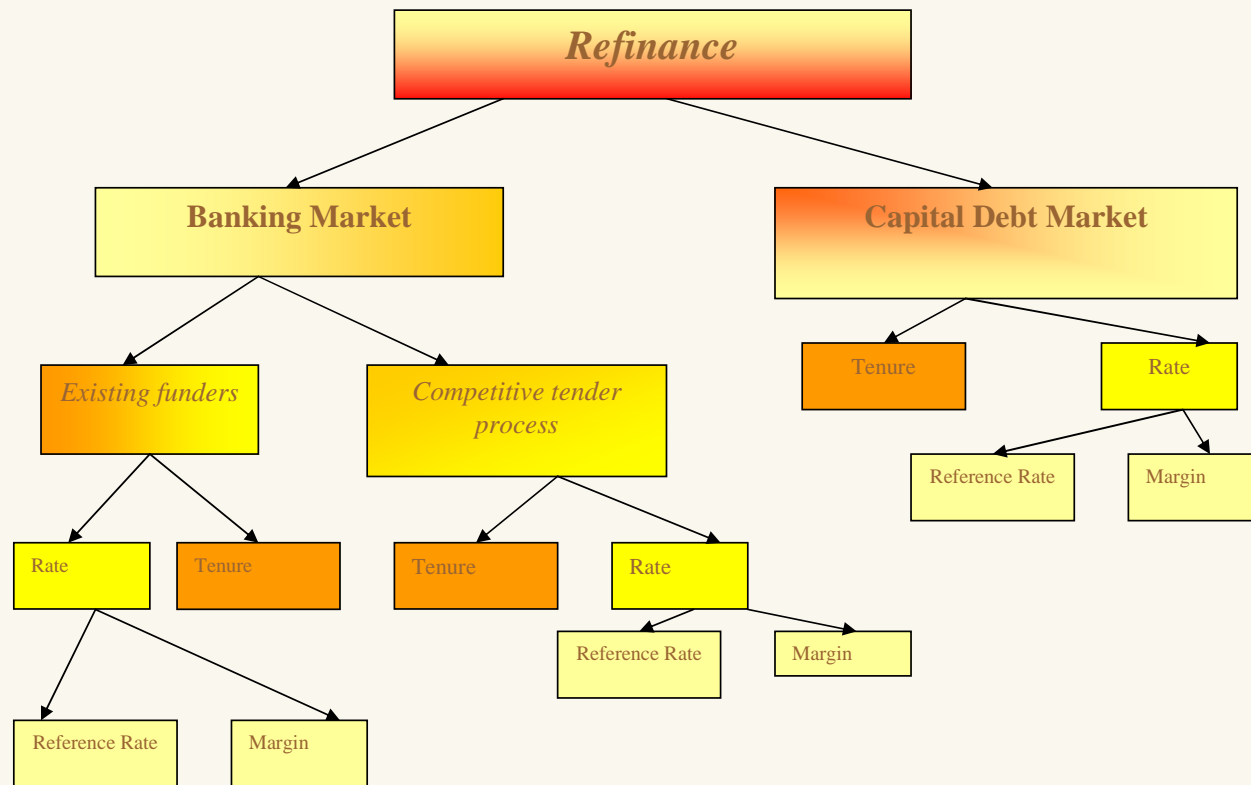
$$\text{DCS payment to operators} = \text{Indexed Fee} + \text{Capital Fee}$$

Operation costs  
(linked to J-factor  
per contracts)

Repayment of Debt  
Funding  
(linked to K-factor  
per contracts)



# Pure Refinancing





## Pure Refinancing

- Conducted financial analysis / model which shows the interest saving / additional cost when:
  - a) the rates are changed to current market rates,
  - b) the term is extended to the end of the concession period
  - c) a combination of a) and b); and
  - d) Breakage costs are:
    - Paid upfront
    - Capitalised into new funding
- Analysed the legal documentation and legal framework as it would apply to execution of refinancing options;

	<u>MCC</u>	<u>KS</u>
Concession start date	30 September 2001	24 March 2000*
Concession end date	29 September 2026	23 March 2025
Concession period remaining	21 years 8 months	19 years 11 months 8 days
Date of first draw down	31 March 2000	16 August 2000
Last debt repayment date	31 March 2015	31 July 2018
Funding period remaining	10 years 2 months	13 years 6 months



## Pure Refinancing

### Mangaung Correctional Centre (“MCC”) - Bloemfontein

- Funded as follows:

- **Funders:** Investec and ABSA

- **Direct funding:** Term funding R436 million - 15y SWAP rate +2,25% fixed at 16% on financial close

- **Indirect funding:** Shareholders Loans: R40.5 million – JIBAR + 6%

- **Refinancing capital balances:**

- Direct funding: R398,482

- Shareholder loan funding redeems 66 months after drawdown date, thus not viable to refinance

- **Refinancing constraints:**

- Breakage costs pertaining to fixed rate SWAP – destroys economic value for money

- Steps /procedures in agreements – onerous

- Limited buy-in / incentive for existing operators' value-for-money objectives

- Overall finding: For future funding arrangements re-financing regimes must be developed to be flexible and embedded upfront in agreements

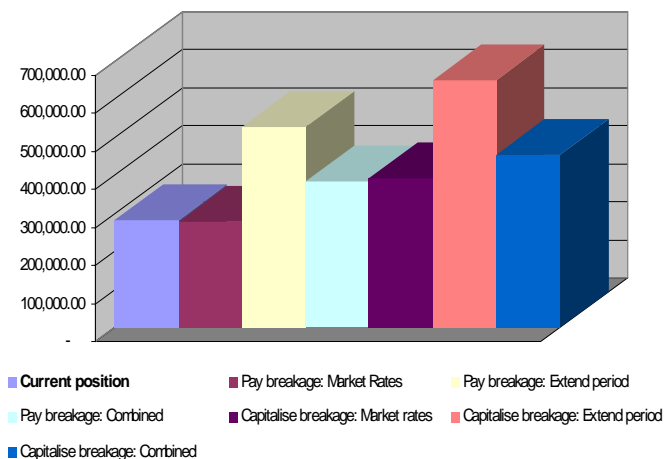


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# Pure Refinancing

## Correctional Centre ("MCC") - Bloemfontein

Future cashflows per prisoner



Based on information and market data as at Jan 2005, indicatively only

	No Refinance	Pay breakage			Capitalise breakage		
		Refin: At market rates	Refin: Extend term	Refin: combined	Refin: At market rates	Refin: Extend term	Refin: combined
Outstanding debt	398,482,761	398,482,761	398,482,761	398,482,761	398,482,761	398,482,761	398,482,761
Rate of funding	16.83%	10.79%	16.83%	10.79%	10.79%	16.83%	10.79%
Pay breakage upfront		145,871,142	145,871,142	145,871,142			
Capitalise breakage in new funding					145,871,142	145,871,142	145,871,142
Refinancing outstanding debt	398,482,761	398,482,761	398,482,761	398,482,761	544,353,903	544,353,903	544,353,903
Total future cash flows (capital and interest)	829,819,255	820,891,085	1,539,507,835	1,122,271,917	1,146,740,673	1,903,800,233	1,333,828,272
Number of prisoners	2,928	2,928	2,928	2,928	2,928	2,928	2,928
Number of days remaining until loan maturity	3,562	3,562	7,305	7,305	3,562	7,305	7,305
Cash flow cost per prisoner per day	79.56	78.71	147.61	52.47	109.95	89.01	62.36
Nominal Saving compared to current		0.86	(68.05)	27.09	(30.39)	(9.44)	17.20
Present Value of Future cash flows	322,568,172	394,063,380	416,474,182	355,600,436	348,106,654	408,933,184	286,504,137
Present value cash flow per prisoner per day	30.93	37.78	19.47	16.63	33.38	19.12	13.39
Present Value saving compared to current		(6.86)	11.46	14.30	(2.45)	11.81	17.53
Nominal future cash flow per prisoner	283,408.22	280,358.98	525,788.20	383,289.59	391,646.40	650,205.00	455,542.44
Present value of future cash flow per prisoner	110,166.73	134,584.49	142,238.45	121,448.24	118,888.88	139,662.97	97,849.77





## Pure Refinancing

### Kutama Sinthumule Correctional Centre (“KS”) – Makadu

- Funded as follows:

- **Funders:** Nedbank and FNB

- **Direct funding:** Term funding R428 million – R157 +2.50%

- Tranche A: R 350 million

- Tranche B: R 78 million

- **Refinancing capital balances** R442,041,058:

- Tranche A: R 356,699,639

- Tranche B: R 85,341,419

- Refinancing constraints:**

- Breakage costs future loss of interest derived from fixed rate bank SWAP costs – destroys economic value for money

- Steps /procedures in agreements – onerous

- Limited buy-in / incentive for existing operators' value-for-money objectives

- Overall finding: For future funding arrangements re-financing regimes must be developed to be flexible and embedded upfront in agreements

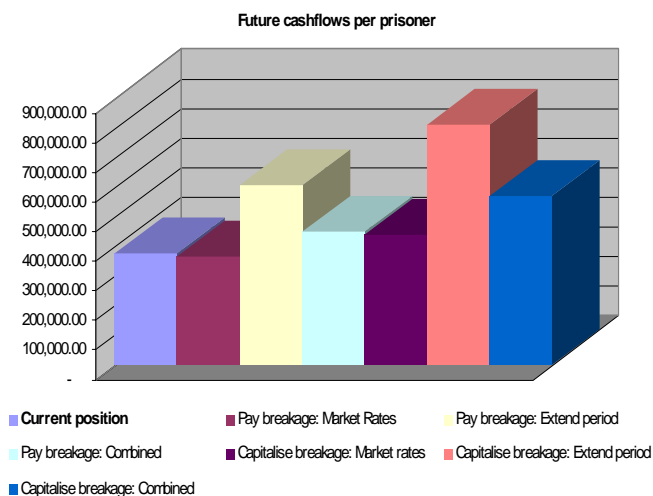


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# Pure Refinancing

## Correctional Centre ("KS") – Makadu

Based on information and market data as at Jan 2005, indicatively only



		Pay breakage				Capitalise breakage	
	No Refinance	Refin: At market rates	Refin: Extend term	Refin: combined	Refin: At market rates	Refin: Extend term	Refin: combined
Outstanding debt	442,041,058	442,041,058	442,041,058	442,041,058	442,041,058	442,041,058	442,041,058
Rate of funding	16.67%	10.72%	16.67%	10.72%	10.72%	16.67%	10.72%
Pay breakage upfront		243,099,206	243,099,206	243,099,206			
Capitalise breakage in new funding					243,099,206	243,099,206	243,099,206
Refinancing outstanding debt	442,041,058	442,041,058	442,041,058	442,041,058	685,140,264	685,140,264	685,140,264
Total future cash flows (capital and interest)	1,151,788,987	1,117,514,026	1,839,996,891	1,371,953,278	1,339,693,797	2,459,504,031	1,734,061,181
Number of prisoners	3,024	3,024	3,024	3,024	3,024	3,024	3,024
Number of days remaining until loan maturity	4,748	4,748	7,305	7,305	4,748	7,305	7,305
Cash flow cost per prisoner per day	80.22	77.83	83.29	62.11	93.31	111.34	78.50
Nominal Saving compared to current		2.39	(3.07)	18.11	(13.09)	(31.12)	1.72
Present Value of Future cash flows	335,254,029	495,578,288	563,924,242	468,190,980	391,329,225	497,261,840	348,880,347
Present value cash flow per prisoner per day	23.35	34.52	25.53	21.19	27.26	22.51	15.79
Present Value saving compared to current		(11.17)	(2.18)	2.16	(3.91)	0.84	7.56
Nominal future cash flow per prisoner	380,882.60	369,548.29	608,464.58	453,688.25	443,020.44	813,328.05	573,432.93
Present value of future cash flow per prisoner	110,864.43	163,881.71	186,482.88	154,825.06	129,407.81	164,438.44	115,370.49



## Design and Operations

### **Objective :**

- *To unlock value for money*
- *Improve cashflow for DCS*

### **Two private operators approached**

- *Kutama Sinthumule proposal contains 7 specific options;*
- *Mangaung proposal very high level and contains no indication of possible savings;*

➤ *Mangaung statement :*

*“.....No significant cost reductions could be established within the current contract specifications.”*

- *Areas of investigation limited to high impact cost drivers.*
- *Practical and executable always at forefront*
- *Limited room for negotiations*

***Both contracts contain NO indication of sharing of any savings.***



## Design and Operations

As at May 2005

FACILITY	CAPACITY	Cost per Offender per day		TOTAL
		Indexed	Fixed	
Mangaung (M)		R145,02	R83,50	R228,52
Kutama Sinthumule (KS)	3024	R123,91	R73,91	R197,82



# Design and Operations

## *Kutama Sinthumule Proposals:*

1. *306 additional offender beds*
2. *270 additional offender beds (additional to 306)*
3. *Construction of new 3,000 bed centre*
4. *Guarantee Fees*
5. *Taxation – VAT requirements*
6. *Change in insurance specifications*
7. *Change in reserve requirements*

***Minimum  
capex for FFE***



## Option 1: 306 additional beds

- Capex to fund FF&E – R2.5m
- Additional indexed fee per offender per day : R67.22
- Additional fixed fee per offender per day : R9.01
- Total capacity : 3024 beds
- Total rate per offender per day : R274,05

## *Funding options to finance FF&E and start-up costs*

- DCS makes upfront cash payment;
- KS raises funds from banking market;
- DCS/KS restructures reserve requirements and use to fund.

## *Subject to :*

- Engineering satisfaction of services
- Penalty regime
- More detailed calculations



## Option 2: 576 additional beds

- Capex to fund FF&E – R5.8m
- Additional indexed fee per offender per day : R64.50
- Additional fixed fee per offender per day : R8.45
- Total capacity : 3600 beds
- Total rate per offender per day : R270,77

Potential R3 per offender per day saving in the long run if capacity increased without alterations to infrastructure with a minimum capex spent on FFE and start-up costs.



## Design & Operations

- *Taxation – VAT Treatment*
  - *Custodial services to be exempted from VAT;*
  - *SARS discussion to follow however it relates to capital grants rather than unitary payments;*
- *Guarantee Fees*
  - *DCS to guarantee 100% to funders in event of default;*
  - *Saving of R977,000 per annum for taking on a huge risk;*
  - *KS suggest split of saving 70% to DCS and 30% to KS;*
  - *This is a no go discussion*





## Design and Operations

### *Insurance Specifications:*

- *Assets all risks:*
  - ✓ *a possible saving of 10% of the annual premium. KS will split this saving 80% KS, 20% DCS.*
- *Assets-Loss of Revenue (Business interruption):*
  - ✓ *proposal is to reduce indemnity period from 24 months to 12 months. A saving of between R100,000 – R125,000 could be realized which could be shared 50/50 with DCS.*
- *Public Liability:*
  - ✓ *a saving of R100,000 on option (a) if the cover is reduced from R250m – R150m, which could be split 50/50 with DCS.*
  - ✓ *On option (b), DCS self insures for this risk, KS will be liable for R10m and DCS could assume a balance of risk. There is a possible reduction of costs to the value of R750 000 per annum.*



## Design and Operations

### *Maintenance Reserve Accounts*

- *KS suggests that the Common Terms Agreement (“CTA”) be reviewed*
- *Critical ratios such as Debt Service Reserve, Maintenance Reserve and Indemnity Account be maintained*
- *Operational Reserve and Rectification Account be eliminated*
- *Currently the Operational and the Rectification Account Reserves amount to a cumulative amount of approximately R16 million collectively*
- *If these reserves are released or lowered, a portion of these reserves could be used to fund the purchase of FF&E and initial start up costs required for the addition of 576 offender beds.*



## Fee Structures

*In our view no real possibility for effecting changes to fee structure as PPP operators indicated reluctance to initiate discussions in this regard.*



## Recommendation and Way Forward

### *Report to DCS in September 2005, recommended that:*

- The increase in bed space in Mangaung in the current units – 570 additional places;
- Increase in the offender population by means of the additional residential units to the current 6 without significant cost to the current infrastructure – 1500 additional beds;
- The increase in bed space in Kutama Sinthumule by additional 576 additional beds
- Revisit :
  - ✓ Insurance Specifications;
  - ✓ Reserve Requirements;



## Conclusion

- *Pure refinancing – no potential gains as breakage costs to high*
- *Operations and design - minimum savings in long run with increase in current capacity*
- *Both contracts do not stipulate sharing of gains*